

701—302.41(422) Capital gain exclusion for elected employee-owned stock in a qualified corporation.

302.41(1) *In general.* Employee-owners may make a single, irrevocable lifetime election to exclude from net income the net capital gain from the sale or exchange of capital stock from a qualified corporation at the following rates:

- a. For tax years beginning in the 2023 calendar year, 33 percent.
- b. For tax years beginning in the 2024 calendar year, 66 percent.
- c. For tax years beginning on or after January 1, 2025, 100 percent.

302.41(2) *Definitions.* Unless otherwise indicated in this rule or required by the context, all words and phrases used in this rule that are defined under Iowa Code section 422.7(43) shall have the same meaning as provided to them under that Iowa Code section.

302.41(3) *Qualifying for the exclusion.* For the employee-owner's sale or exchange to qualify for the exclusion in this rule, the capital stock must be acquired by the employee-owner while employed and on account of employment with a qualified corporation.

a. *While employed.* The capital stock must have been acquired while the employee-owner was employed by the qualifying corporation. Capital stock received as compensation is acquired by the employee-owner while employed. Capital stock acquired from a stock right, stock warrant, or stock option is only acquired by the employee-owner while employed if such right, warrant, or option is exercised while the employee-owner is employed by the qualifying corporation.

b. *On account of employment.* For capital stock to have been acquired on account of employment, the employee-owner must have acquired the capital stock in a manner only available to employees of the qualified corporation. Capital stock acquired at formation in exchange for capital contribution is not acquired on account of employment.

c. *Holding period.* To qualify for the exclusion, the employee-owner must own the capital stock for at least ten cumulative years. If the employee-owner owns any capital stock in the qualified corporation for at least ten cumulative years, then every share of the employee-owner's capital stock in that qualified corporation is considered to meet the holding period requirement. For stock rights, stock warrants, or stock options, the holding period does not begin until the right, warrant, or option is exercised.

302.41(4) *Electing capital stock for exclusion.*

a. *General rule.* The employee-owner shall make the election to exclude capital gain from the sale of capital stock of a qualified corporation on a form prescribed by the department with the employee-owner's original Iowa income tax return for the tax year in which the election is made. The form shall be available on the department's website. To qualify for the exclusion, the employee-owner must include all information required by the form.

b. *Election when sale or exchange takes place over multiple transactions.* The election applies to all subsequent sales or exchanges of capital stock of the same qualified corporation of which the initial election was made, within 15 years of the date the election was made. The employee-owner shall include the form prescribed by the department with the employee-owner's Iowa income tax return when claiming the exclusion for a subsequent sale or exchange.

c. *The election can only be made once.* An employee-owner may only make one lifetime election to exclude the qualifying capital stock of a single qualifying corporation under this rule. The election is irrevocable once made.

302.41(5) *Election by a party other than the employee-owner.*

a. *Election upon death of the employee-owner.* If the employee-owner dies after having sold or exchanged qualifying capital stock without having made an election, the surviving spouse or, if there is no surviving spouse, the personal representative of the employee-owner's estate may make a qualifying election in the manner described in subrule 302.41(4) for the tax year in which the employee-owner died.

b. *Inter vivos transfer of qualifying capital stock.* After the election described in this rule has been made, the election applies to capital stock transferred from the employee-owner to the employee-owner's spouse as an inter vivos gift or to an inter vivos trust primarily for the benefit of the employee-owner's spouse. Capital stock transferred through a will or testamentary trust does not qualify for this exclusion.

The election only applies if the spouse was married to the employee-owner on the date of the sale or exchange or the date of death of the employee-owner.

This rule is intended to implement Iowa Code section 422.7.
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